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STATEMENT OF
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UNITED STATES GENERAL ACCOUNTING OFFICE
BEFORE THE
SENATE COMMITTEE ON GOVERNMENTAL AFFAIRS
CONCERNING S. 864 THE PROPOSED
FINANCIAL INTEGRITY ACT OF 1981

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Mr. Chairman and Members of the Committee:

I am pleased to have this opportunity to appear before the Committee on behalf of the General Accounting Office to discuss the bill, S. 864, the proposed "Financial Integrity Act of 1981."

A seemingly unending disclosure of fraud, waste, abuse, and mismanagement in Government during the 1970s has surfaced a serious crisis of confidence in the way Federal Government programs and agencies are managed. Federal departments and agencies cannot properly account for their activities without strong and effective control over operations. Internal control systems properly conceived, soundly based, and effectively monitored are the front-line defense against fraud, waste, and abuse. The proposed "Financial Integrity Act of 1981" was designed to strengthen controls by requiring management to monitor, analyze, and report on the adequacy of their systems of internal control. The act would establish within each executive agency a continuous process of reviewing internal control systems, developing action plans for corrections, and reporting on the status of the control systems.

Implementation of the act should consist of three main phases: initial review, plan of action, and an annual review. During the first year, the financial management division would review agency operations and provide the senior agency financial officer, such as the assistant secretary (financial management), a summary of internal control strengths and weaknesses of the various agency components. The senior financial officer would review the detailed evaluation and prepare an overall assessment for the entire agency.

An important requirement of this bill is the periodic report prepared and signed by the head of an agency stating an opinion on the adequacy of the agency's internal control systems. The report would be required to be addressed to the President and made available to the Congress and the public. This requirement would force Federal managers to give a higher priority to implementing effective internal controls and continually monitoring them to ensure that strong controls are maintained.

Management of private corporations have begun including statements on their internal control systems in annual reports to stockholders because the Federal Government encouraged them to do so. An international accounting firm recently published a study on management reports and included numerous examples of actual statements appearing in annual stockholders reports. The following statement from the Xerox Corporation is one example included in the study. "Xerox maintains a system of internal accounting controls designed to provide reasonable assurance that assets are safeguarded against loss or unauthorized use and that the financial records are adequate and can be relied upon to produce financial statements in accordance with generally accepted accounting principles. The concept of reasonable assurance is based on the recognition that the cost of a system of internal control must not exceed the related benefits. There are written internal accounting and operating control policies and procedures that are communicated to the Company's worldwide operating units. Adherence to these policies and procedures is constantly being evaluated by an extensive coordinated audit effort of our internal

audit staff and independent certified public accountants." The study illustrates the growing trend of reporting on internal controls by management in the private sector. In view of the increased recognition of the need for internal controls in the private sector, I believe the proposed "Financial Integrity Act of 1981" is the legislation that could meet the same need and bring about significant improvement of internal controls in the Federal Government.

The requirements for Federal agencies to maintain internal administrative and accounting control systems have been mandated by law for over 30 years; however, most agencies have not always given adequate priority to their internal control systems. The General Accounting Office (GAO) has issued literally hundreds of reports and studies that disclose the fact that most agencies are operating systems vulnerable to physical losses and waste of Federal property and money are susceptible to fraudulent or otherwise improper use of the Federal resources. For example, one of our recent reports disclosed that over a 2 1/2 year period, 21 Federal agencies experienced some 77,000 cases of known fraud. We estimated that the monetary loss totalled between \$150 million and \$220 million. Aside from fraud alone, waste and abuse can take an alarming toll of Government resources. Three examples we have reported on include:

- About \$700,000 in overpayments were made by one agency because a preaudit of vouchers (a very basic control) was not performed.

--Receivables totalling over \$218 million in another agency went unrecorded resulting in no efforts being made to collect that amount.

--An overobligation of \$205 million was made in one agency because of a serious breakdown in its accounting and financial management reporting systems.

The proposed Financial Integrity Act of 1981 will go a long way toward supplementing the existing legislation by providing the missing link of assurance that strong internal controls will exist. The passage of this act would, in simple terms, put teeth in the Accounting and Auditing Act of 1950, primarily since it would necessitate a continuous assessment of internal controls, plans of action to correct weaknesses, and annual reports on the adequacy of the internal control systems.

Obviously, costs will be incurred in order to realize the benefits to be achieved through implementation of this bill. It will mean a substantial investment in improved systems for many agencies and departments and will require educating management and employees to instill in them a keen awareness of effective controls. However, we believe that the benefits and savings will far outweigh the costs. Also, the Office of Management and Budget, as well as the Inspectors General, have already done some work in this area.

We strongly support this bill, but we believe it could be strengthened if an item is added requiring agency heads to report to the Congress on the status and progress made in having their accounting systems approved by GAO at the time an appropriation is requested. This would provide the Congress direct oversight and feedback on an agency's internal control system.

The basis for this recommendation stems from the fact that many Federal agencies' accounting systems have yet to be approved by GAO. As you know, the Accounting and Auditing Act of 1950 requires GAO approval of the adequacy of all executive agencies' accounting systems. Accounting systems approval is based to a large extent on the adequacy of internal controls. Even after 30 years, only about 63% of the Federal agencies' accounting systems have been approved. In addition, we would like to offer four other suggestions for your consideration which would make S. 864 consistent with H.R. 1526, the Federal Managers' Accountability Act of 1981, which recently was passed in the House.

1. Section 4 of the bill requires the Comptroller General to establish the required reporting systems and evaluation guidelines. We believe the Director, Office of Management and Budget should develop the reporting systems and evaluation guidelines. However, if the Congress believes the General Accounting Office, rather than the Office of Management and Budget, should establish the required reporting systems and evaluation guidelines, we would have no objection.
2. We also suggest that the deadline for establishing the reporting systems and evaluation guidelines be extended 1 year to December 31, 1982.
3. We agree that developing the standards for internal accounting and administrative control is a General Accounting Office responsibility. However, we believe

section 4 could be clarified by requiring the agencies to establish internal accounting and administrative controls based on standards prescribed by the Comptroller General.

4. Section 4 should be clarified to require that all inadequacies or material weaknesses in an agency's internal control systems be identified and the plans and schedule for correcting any inadequacies be described in detail in the agency head's report required by subsection (d)(1).

In conclusion, we believe the importance of this proposed legislation cannot be overstated. Effective internal controls help ensure that Government managers know what their monetary and physical assets and resources are at all times; know how the assets are being used, dispensed, and disposed of and for what purposes; know that such purposes are authorized; and know that fraud, waste, and abuse are minimized and discouraged. This proposed legislation would establish a badly needed discipline to assure close attention to the quality of internal controls and to enhance the accountability of Federal officials. Passage of the Financial Integrity Act of 1981 will serve to bring about the strong commitment and vigilance necessary in the management of Government operations.

Mr. Chairman, this concludes my prepared statement. I would be pleased to respond to any question you or other Members of the Committee may have.